No. 89-924

Supreme Court, U.S.
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In The Supreme Court Of The United States

OCTOBER TERM, 1989

DAVID P. GOULD, et al.,

Petitioners,

v.

ALLECO, INC., et al.,

Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

First, whether the petition to intervene by bondholders of an insolvent, and now dissolved, corporation seeking to challenge a proposed settlement that would pay defrauded stockholders in preference to bondholders was timely if made only ten weeks after the proposed liquidation and dissolution of the corporation and one week before the liquidating transaction took place?

Second, whether the bondholders had standing and sufficient interest to permit intervention as a matter of right?

Third, whether the bondholders, who are currently due the entire principal and interest on their debentures, are entitled to payment of the settlement fund in preference to the stockholder fraud claimants?

Fourth, whether the settlement, which provides for the destruction of

25,000 non-public documents, is consistent with the public policy of limited protective orders underlying Federal Rule of Civil Procedure 26?

LIST OF ALL PARTIES

In addition to the parties listed in the caption of the case, there were a number of other plaintiffs-appellants and defendants-appellees as well as appellants-intervenors and plaintiffs-appellees and defendants-appellees.

In record No. 88-3637, David P. Gould; Marks, Inc.; Lawrence I. Weisman; Phillip Doccolo; Rocko, Inc.; and Patrick L. Day as trustee for James M. Weisman were plaintiffs-appellants while Alleco, Inc.; Morton M. Lapides; Henry Weitz; Edward A. Weisman; Harry J. Conn; David H. Cohen; Robert H. Heller; William D. Houser; Frederic K. Raiff; Arthur F. Staley; David C. Barr; John E. Baker; Jeffry R. Lapides; Heather A. Ditto; Jayme Dorf; Mark A. Garfinkle; David S. Klein; Donn A. Lewis; Jeffrey E. Mann; J. Tighe Merkert; Joan L Nickel; Frank E. Silvestro; Norman B. Weisman; Deborah A

Wenner; C.J. Nelson; Harry J. Kane; Pamela Lapides; Smith, Barney, Harris, Upham & Company; Peat, Marwick, Mitchell & Company, now Peat, Marwick, Main & Company; Laventhol & Horwath; American Security Bank; Perpetual Savings Bank; Squire, Sanders and Dempsey; and Marshall M. Meyer were defendants-appellees.

In record No. 88-3638, Lawrence I. Weisman; David P. Gould; Marks, Inc.; Phillip Doccolo; Rock, Inc.; Patrick L. Day as trustee for James. M. Weisman were appellants-intervenors and Leonard Robinson and Patricia Robinson were plaintiffs-appellees and Allegheny Beverage Corporation; Morton M. Lapides; Henry Weitz; Marshall M. Meyer; Edward A. Weisman; and Harry J. Conn were defendants-appellees.

These two cases were consolidated for purposes of appeal.

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PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
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The petitioners respectfully pray that a Writ of Certiorari issue to review the final judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-captioned proceeding on September 8, 1989.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit holding that bondholders did not have standing to object to the settlement, that the intervenors did not have a sufficient interest to permit intervention of right and that the petition to intervene was not timely is reported at 883 F.2d 281 (4th Cir. 1989) and is reprinted in the appendix at page B-1.

The order of the Court of Appeals denying the petition for rehearing and suggestion for rehearing in banc is reprinted in the appendix at page A-1.

The decision of the District Court denying the petition to intervene and holding the bondholders objections to the settlement invalid, and the reasons for this decision were stated in open court and constitute the opinion of the court.

The relevant portion of the transcript is reprinted in the appendix at page C-1.

The memorandum and order of the United States District Court for the District of Minnesota entering judgment against Alleco, Service America, Lapides Corporation and LP Acquisition Corporation and holding that the interest and principal on the 9 1/2 percent convertible subordinated debentures due 2010 in the amount of $105 million is due immediately is reprinted in the appendix at page D-1.

The Bankruptcy Petition filed against Alleco is reprinted in the appendix at page E-1.

JURISDICTION

The District Court had original jurisdiction both because of diversity and because the litigants' causes of action arose under federal securities

statutes. The judgment of the Court of Appeals was entered on September 8, 1989. The petition for rehearing filed by appellants was denied September 8, 1989. The jurisdiction of the Court is invoked pursuant to 28 U.S.C 1254(1). The petition has been filed within the time allowed by law.

STATUTORY PROVISIONS

Most relevant statutory provisions are set forth in the text of the petition. Six statutes or rules are reprinted in the appendix, however, at the pages designated in the table of contents to the appendix.

STATEMENT OF THE CASE

On July 23, 1986, Leonard and Patricia Robinson sued Allegheny Beverage Corporation and five other defendants on behalf of the class of persons who purchased Allegheny Beverage Corporation stock between May 14, 1985 and June 30, 1986 inclusive, alleging securities fraud under Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 and the common law of Maryland, (S-86-2309). During 1987, Allegheny Beverage changed its name to Alleco, Inc. A settlement agreement was reached whereby Alleco would pay $6.95 million to the plaintiff class. The District Court issued an "Order With Respect to Notice, Settlement Hearing and Administration" on May 17, 1988. That order certified the class pursuant to Rule 23(a) and (b)(3) for purposes of the settlement only. The Stipulation of Settlement was filed with

the court on June 6, 1988. Notice of Proposed Settlement was mailed June 21, 1988 and published in the June 28, 1988 Wall Street Journal. On August 1, 1988, within the period set forth in the District Court's order, petitioners filed an "Opposition of Bondholders to Proposed Settlement". The settlement was opposed because it would pay stockholders in preference to bondholders because Alleco was insolvent and undergoing liquidation. In fact, the Robinson settlement was an integral part of a stepped transaction to dissolve Alleco and take its remaining assets private.

Commencing with a tender offer and liquidation plan instituted on July 13, 1988, of which the Robinson settlement was a key component, Alleco was merged into LP Acquisition Corporation on October 18, 1988, and is no longer a corporate entity of the State of Maryland

or any other state. The assets which had belonged to the public convertible debentureholders and the stockholders of ABC were transferred in full to a corporation called Lapides Corporation (affiliated with LP Acquisition Corporation) of which Morton M. Lapides is the controlling stockholder.

On August 15, David Gould, et al., filed suit against Alleco, Inc., et al. on behalf of the class of persons who purchased or purchased and sold the 9 1/2 percent convertible debentures of Alleco on or after September 1, 1985, for violations of the Securities Act of 1933, Section 10(b) of The Securities Exchange Act of 1934 and Rule 10 (b)(5), for derivative claims against Alleco management, for improperly giving priority to stockholders over bondholders in the payout of a limited Fund, for RICO violations, under the Investment Company

Act of 1940, and alleging the invalidity of the tender offer commenced July 7, 1988. The complaint asked, among other things, that Alleco be declared an investment company within the meaning of the 1940 Act, that a receiver be appointed to take charge of Alleco's assets and those of the Lapides family, that independent counsel be appointed to investigate all claims against Alleco, including whether the Robinson settlement was collusive, that damages be awarded to the plaintiff class, that an injunction be granted enjoining the tender offer, the merger between Alleco and Lapides Corp., and the payment of further Alleco Funds because of the fraudulent actions of Lapides and that Alleco be placed in bankruptcy under Chapter 11.

On September 2, Gould, et al., filed an amended complaint which reiterated the original complaint and made additional

contract and securities fraud claims based specifically on the indentures and taking into account new facts disclosed in Lapides' criminal trial and sentencing before Judge Doumar of the United States District Court for the Eastern District of Virginia and asked for an injunction against the Robinson settlement.

On September 6, Lawrence I. Weisman, et al., moved to intervene pursuant to Rule 24 (a)(2) in the Robinson case and requested a delay of 30 days in the Settlement Hearing. The Motion to Intervene stated that payment of the Robinson settlement may, as a practical matter, make it impossible for the bondholders to obtain full relief since Alleco did not have sufficient net worth to pay the bondholders and the Robinson class.

At the hearing, September 6, 1988, the District Court denied the Motion to

Intervene and Delay Settlement. The Court further issued an order mooting the Gould complaint to the extent it sought relief of any kind against the Robinson settlement. The Court denied the Motion for a Temporary Restraining Order and the motion to place Alleco in receivership.

Less than two years after $105 million of the 9 1/2 percent convertible debentures were issued, ABC attempted to disclaim liability on those debentures on the theory that Servam and Service America Corporation were the substitute obligors. ABC's purported elimination of the conversion rights in a tender offer and merger transaction, which was begun on July 13, 1988 and completed on or about September 13, 1988, caused a catastrophic fall in the market value of those debentures to approximately $55.00 per debenture -- a loss for the public debentureholders of over $50 million.

Petitioners own about $4 million of the 9 1/2 percent debentures.

The issue of whether Alleco has successfully substituted Servam Corporation as the obligor as a result of Alleco's disposition of its Service America Corporation subsidiary and whether Alleco had evaded all liability to remaining Alleco debentureholders was litigated in the United States District Court for the District of Minnesota. Alleco v. IBJ Schroeder Bank & Salomon Brothers; Salomon Brothers intervenor and counterclaim-plaintiff with Alleco, Inc. and Service America Corporation as counterclaim-defendants (3-87-802), and in the Maryland District Court case IBJ Schroder Bank v. Alleco, In., Lapides Corporation, LP Acquisition Corporation and Service America Corporation (88-2170). Action in the latter case was stayed pending the outcome of the

Minnesota litigation.

The Minnesota District Court ruled, conincidently on the same day that the Fourth Circuit handed down its decision, that "Alleco and its controlling shareholder have flaunted the Indenture and have pursued these schemes with utter disregard for the rights of the Debentureholders. This conduct violated numerous terms of the Indenture." The court further held that Alleco was in default and that the principal and interest on the debentures was immediately due and payable. Judgment was entered against Alleco, Service America, Lapides Corporation and LP Acquisition Corporation. App. at D-1.

To the petitioners knowledge, the only remaining asset of Alleco, which is no longer in existence, is the $6.95 million Robinson settlement fund at issue in this case. Thus, precisely the

inability to pay that was the foundation of petitioners original petition to intervene has come to pass.

REASONS FOR GRANTING THE WRIT

A. THE PETITION TO INTERVENE BY BONDHOLDERS OF AN INSOLVENT, NOW DISSOLVED, CORPORATION AGAINST A PROPOSED SETTLEMENT THAT WOULD PAY DEFRAUDED STOCKHOLDERS IN PREFERENCE TO BONDHOLDERS WAS TIMELY IF MADE ONLY EIGHT WEEKS AFTER THE PROPOSED LIQUIDATION AND DISSOLUTION OF THE CORPORATION AND ONE WEEK BEFORE THE LIQUIDATING TRANSACTION TOOK PLACE.

The appellants filed an objection to the settlement on August 1, 1988, sought to enjoin the settlement on September 2, 1988 and sought to intervene in this case on September 6, 1988. The intervention was sought ten weeks after the notice of proposed settlement was mailed to the class on June 21, 1988, nine weeks after notice by publication in the June 28 Wall Street Journal, eight weeks after the announcement of the liquidating transaction on July 13, 1988, and one week before the liquidating transaction was completed. The motion to intervene was timely within the meaning of Rule 24(a). On many occasions courts have even

allowed post-judgment interventions. See, e.g. United Airlines, Inc. v. McDonald, 432 U.S. 385, 53 L.Ed 2d 423, 97 S.Ct. 2462 (1977) at note 16. Moreover the cases make it clear that the timeliness requirement should be liberally construed with respect to interventions of right as compared to permissive interventions. See Hardy-Latham v. Wellons, 415 F.2d 674 (4th Circuit 1968); Fleming v. Citizens for Albermarle, 577 F.2d 236 (4th Circuit 1978) cert. denied 439 U.S. 1071, 99 S. Ct. 842, 59 L.Ed.2d 37 (1979). The District Court ruled that the intervention was not timely.

The Court of Appeals accepted the reasoning of the District Court. Both courts focused on the period of years that had elapsed since the original Robinson action was filed. The Court of Appeals' analysis centers on May 17, 1988 -- the date that the proposed settlement

was presented to the District Court. But that date is utterly irrelevant. The relevant period is the period elapsing between the date that the liquidating transaction was announced, July 13, 1988 and the date that the petition to intervene was filed, September 6, 1988 -- a period of less than seven weeks. Before the liquidation was announced, bondholders were not facing the prospect that their creditor, Alleco, would simply dissolve in violation of the Indenture and leave them without recourse. The liquidating transaction occurred September 13, 1988, one week after the petition to intervene and the corporation ceased to exist on November 9, 1988, eight weeks after the petition to intervene.

B. THE BONDHOLDERS HAD STANDING TO INTERVENE AND A SUFFICIENT INTEREST TO PERMIT INTERVENTION AS A MATTER OF RIGHT.

ANY OTHER INTERPRETATION ALLOWS PUBLIC COMPANIES' MANAGEMENT TO GO PRIVATE, PAYING DISSIDENT STOCKHOLDERS, AND LEAVING THEIR PUBLIC DEBENTUREHOLDERS WITH RECOURSE ONLY TO HIGHLY LEVERAGED AND INSOLVENT SUBSIDIARIES. MOREOVER, AN UNDULY NARROW INTERPRETATION OF STANDING AND INTEREST REQUIREMENTS IN CLASS ACTION LITIGATION GENERALLY WILL ALLOW INSOLVENT FIRMS TO FAVOR SOME CREDITORS AT THE EXPENSE OF OTHERS IN DEROGATION OF THE PUBLIC INTEREST.

The District Court appeared to accept the allegation of Respondent's counsel that neither debenture holders nor other non-members of the class could intervene in a settlement proceeding. The Court of Appeals explicitly held that "non-class members have no standing to object, pursuant to Rule 23(e) notice directed to class members, to a proposed class settlement. Interjection of the opposing views of non-class members should proceed via intervention under Rule 24." App. at B-10.

Over the years, various appellate courts have pointed out that

Rule 23(e) of the Federal Rules of Civil Procedure imposes an independent duty upon the approving court to protect the public and those parties who are not before the Court. Rule 23(e) is not designed to protect merely members of the class chosen by plaintiffs' counsel. It is designed to protect parties with an interest in the funds before the Court as defined in Rule 24(a)(2) of the Federal Rules of Civil Procedure as well as necessary parties as defined by Rule 19(a)(2) of the Federal Rules of Civil Procedure. These guidelines are particularly important in a case like this where a class is not certified prior to settlement. Moreover, courts have given non-class members "standing" to object to settlements.

One of the best illustrations of the reason for the rule is found in Piambino v. Bailey, 757 F.2d 1112 (11th

circuit, 1985). In that case, a state court class had obtained a judgment before a federal court class had been certified. Eventually the federal court class succeeded in having the state court judgment set aside in its own favor. Upon intervention on behalf of the state court class, the federal court judgment, certification of class, and award of attorneys fees was reversed by the Court of Appeals for the Eleventh Circuit in a stinging rebuke which might well be read to apply to this case.

The Court brushed aside objections to the settlement on the grounds that the intervenors had no standing.

> "The district court approved Lead Counsel's proposed attorney's fee because 'no one opposed it'; Sylva's objection did not count because he was not a party. Such perfunctory approval, the Piambino I panel held, constituted a complete abdication by the court of 'its responsibility to assess the

> reasonableness of attorney's fees proposed under a settlement of a class action,' 610 F.2d at 1328, and, standing alone, was sufficient to vitiate the settlement. Id. Of course, the settlement was also invalid because of its highly prejudicial treatment of the Minority Group.
>
> The Rule 23 policies that dictate the conduct of the trial judge and plaintiffs' counsel in class actions simply cannot accommodate the decision Lead Counsel urge us to make, which would allow Lead Counsel and the settling plaintiffs to retain the proceeds of the Bestline settlement." Piambino v. Bailey, 757 F.2d 1112, 1140.

In In Re Pittsburgh and Lake Erie Railroad Company, 543 F.2d 1058 (3rd Circuit, 1976) Irving Trust Company was the trustee under an indenture by the Pennsylvania Railroad (Penn Central). Penn Central, before its bankruptcy, pledged 22.5% of P&LE's stock to Irving as trustee for the Penn Central debentureholders.

During the course of the Penn Central bankruptcy, shareholders class action and derivative actions were brought on behalf of P&LE's minority stockholders who held approximately 7% of P&LE's stock.

Settlement was made between Penn Central, the minority and derivative stockholders, and certain officers and directors of P&LE. All parties contended that the Third Circuit could not disapprove a settlement because Irving was a nonparty just as all respondents in this case claim that the petitioners are non-parties.

The Third Circuit disagreed and held not only that Irving had standing to be heard on its objection to the settlement but that the District Court abused its discretion in approving the settlement. In substance, Irving stated that its bondholders were under-secured just as

the convertible debentureholders are in this case and the Third Circuit found also that the proposed settlement "would delete pledgee's equity in P&LE by approximately $472,500 and would further deplete the net working capital of P&LE".

The Court of Appeals for the Third Circuit, in contrast to the Fourth Circuit, found that Irving's standing to objection to the settlement depended upon whether the security of its bondholders would be adversely affected by the implementation of the settlement. The Third Circuit found, just as the petitioners have argued with respect to Alleco in this case, that Irving Trust had a duty not only under the common law but also under the Trust Indenture Act of 1939.

> We have often said that in reviewing a court-approved settlement we utilize an abuse of discretion standard. In this case, for a minimal if not

> non-existent benefit to P&LE, the settlement costs that corporation $2,100,000. The actual benefits flow only to plaintiffs' attorneys and the 7% minority stockholders. The form of the settlement assumes that only Penn Central, the chief beneficiary of the alleged wrongdoing, is interested in the other 93%. It ignores the patent reality that as to the 22.5% of P&LE stock, Penn Central's interest is, in an equitable sense, slight or non-existent. It ignores the conflict of interest between Penn Central as pledgor and alleged wrongdoer and Irving as innocent pledgee. We have no hesitation in holding that the district court's approval of this settlement was an abuse of discretion. In Re Pittsburgh and Lake Erie Railroad Company, 543 F.2d 1058 (3rd Circuit, 1976)

The petitioners should have been allowed to intervene as a matter of right. Federal Rule of Civil Procedure 24 states:

> **(a) Intervention of Right. Upon timely application anyone shall be permitted to intervene in an action: (1) when a statute of the United States**

> confers an unconditional right to intervene; or (2) when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately represented by existing parties.

The District Court ruled that "to say that a shareholder who is not a member of the class or a general creditor or trade creditor or a holder of a debt instrument can intervene with regard to the fairness hearing portion of a class action settlement is not an appropriate construction of Rule 24. I don't think it allows any such thing." App. at C-3. It

is difficult to think of any more appropriate construction of Rule 24 than when bondholders are trying to protect their superior interests against shareholders in the case of an insolvent corporation with a limited fund. The rule has been so construed in the past by other courts. Cf. In Re Pittsburgh and Lake Erie Railroad Company, 543 F.2d 1058 (3rd Circuit, 1976) discussed above.

Intervenors must meet a three part test. First, the proposed intervention must have merit. Second, in the absence of intervention, the interest may be impaired. Third, the present litigants must not adequately represent the interest. United Guaranty Residential Insurance Company v. Philadelphia Savings Fund, et al., 819 F.2d 473 (4th Circuit, 1987); Virginia v. Westinghouse Electric, 542 F.2d 214, 216 (4th Circuit, 1976).

Petitioners meet these three tests.

First, the intervenors' case has merit, as the Minnesota District Court decision demonstrates. Second, the petitioners will probably lose, dollar for dollar, everything paid to the Robinson class and its lawyers since Alleco is insolvent, dissolved and now a bankruptcy petition is pending. Third, the present litigants' interests are diametrically opposed, given the situation, to those of the creditors.

Respondents and the Court of Appeals, at App. B-1, placed great reliance on Kusner v. First Pennsylvania, et al, 74 F.R.D. 606 (1977), aff'd. 577 F.2d 726 (3rd Circuit, 1978). That case is inapposite. First, petitioners are intervening under Rule 24, rather than Rule 23(d) under which Kusner was decided. Second, the facts in Kusner are the reverse of this case. In that case, a stockholder of a solvent corporation

tried to stop a settlement with debentureholders. In this case debentureholders are trying to stop a settlement paying stockholders of an insolvent corporation.

In Securities Exchange Commission v. Flight Transportation Corporation, 699 F.2d 943 (8th Circuit, 1983), the Securities and Exchange Commission brought a fraud action against a group of defendants. Greyhound Leasing and Financial Corporation brought a motion to intervene as a matter of right under Rule 24(a)(2). The trial judge denied their motion stating that their interests had not been shown to be "adversely affected" and were hypothetical. The Eighth Circuit Court of Appeals, in contrast to the Fourth Circuit, reversed the denial of intervention. It pointed out that "as a practical matter FTC has no assets other than the $22 million the SEC

seeks." Greyhound had also met the 'single minimal' burden of showing that its interests may not be adequately represented by existing parties". Greyhound had a "disparate" interest to warrant intervention, namely its interest in protecting its rights as a lessor which as a practical matter was foreclosed since the corporation involved would have no assets left to protect Greyhound's security interest. See also, Trbovich v. United Mine Workers of America, 404 U.S. 528, 538 (n.10), 925 S.Ct. 630, 30 L.Ed.2d 686 (1972).

It was probably only Alleco's debenture holders whose claim of about $4,000,000 was as large as the class settlement who had standing to raise the bondholder issues as opposed to the trustee. In In Re Equity Funding Corporation of America Securities Litigation, Chemical Bank as Indenture

Trustee, et al. Appellants v. Sylvia Confino, et al as Representative of the Plaintiff classes Appellees, 603 F.2d 1353 (9th Circuit 1979), the Court of Appeals for the Ninth Circuit dealt with the standing of Chemical Bank. It pointed out that Chemical Bank was not a member of the plaintiff classes in the MDL securities litigation and added that "*** nor is it otherwise a claimant to any portion of the settlement fund." The question, therefore, arises as to its standing to object to the plan of allocation and to appeal from the order of the MDL court approving the offset provision of said plan ***", 603 F.2d 1353. The Ninth Circuit panel pointed out that neither Chapter 11 of the old Bankruptcy Act nor any of the Supreme Court decisions nor the Trust Indenture Act of 1939, gave Equity Funding standing to issues as to between debenture holder

classes of security holders and stockholder classes of security holders. The Ninth Circuit Panel held that Chemical Bank could not be a representative in the class action but that, on the contrary, the debenture holders class was properly represented by class representatives appointed by the trial court. Likewise in this case, the conclusion is correct that in arguments between classes, the indenture trustee has no standing but only bondholder members. The Ninth Circuit concluded its discussion of standing by stating, "Consequently, we agree with the MDL Court that Chemical Bank lacks standing to object to or appeal from the plan of allocation or its approval by the court below. However, the individual appellants as debenture holders and members of the plaintiff class clearly had standing to object for the purposes of this appeal.

We, therefore, turn to their arguments."

If the Fourth Circuit's narrow interpretation of the right of non-class members to object to a settlement or to intervene is allowed to stand, then public companies' management will be able to go private, paying dissident shareholders but leaving their public debentureholders with recourse only to highly leveraged and insolvent subsidiaries. It is important, particularly with the ever-increasing degree of leveraged and management buy-out activity that bondholders be afforded an adequate opportunity to be heard. Moreover, this vary narrow interpretation will have an adverse impact on the ability of many persons in other kinds of litigation to protect their rights.

C. THE SETTLEMENT FUND SHOULD NOT BE PAID IN DEROGATION OF THE RIGHTS OF THE DEBENTURE HOLDERS. ANY OTHER RULE ALLOWS

PUBLIC COMPANIES' MANAGEMENT TO GO PRIVATE, PAYING DISSIDENT STOCKHOLDERS, AND LEAVING THEIR PUBLIC DEBENTUREHOLDERS WITH RECOURSE ONLY TO HIGHLY LEVERAGED AND INSOLVENT SUBSIDIARIES.

1. PAYMENT OF THE SETTLEMENT FUND WOULD IMPROPERLY COMPLETE THE DISSOLUTION AND LIQUIDATION OF ALLECO CONTRARY TO LAW

The Settlement fund should not be paid because payment would, in effect, distribute the last remaining assets of a dissolved and liquidated corporation to the shareholders in preference to the legitimate claims of the debenture holders.

Alleco was dissolved effective November 9, 1988. At that time, all of Alleco's assets except for the Settlement Fund were paid to Alleco's sole remaining shareholder, Lapides. If the Fund is also now paid to the shareholders, this would complete the dissolution and liquidation of Alleco by distribution of all of the assets to shareholders without

paying the claims of any creditors, including petitioners and other debentureholders.

Section 3-410(b) of the Maryland General Corporation Law provides that when a corporation is dissolved, the directors shall

> (1) Collect and distribute the assets, applying them to the payment, satisfaction, and discharge of existing debts and obligations of the corporation, including necessary expenses of liquidation; and
> (2) Distribute the remaining assets among the stockholders.

Section 3-412 provides for distributions to shareholders in a voluntary dissolution "[i]f. . .assets are available for distribution to stockholders."

Maryland Corporations and Associations Section 3-419(a) states:

> (a) Liability in general. -- The voluntary or involuntary dissolution of a corporation does not

> relieve its stockholders, directors, or officers from any obligation or liability imposed on them by law.

Thus Alleco and the Robinson stockholders cannot avoid their liability to bondholders simply by dissolution. A corporation may not pay a dividend (Section 2-309) or acquire its own stock (Section 2-312(c)) if it is insolvent. That is precisely what the Robinson settlement constitutes.

The effect of these provisions is to prohibit a dissolved Maryland corporation from distributing assets to the shareholders until obligations to creditors have been satisfied. Distributing the Settlement Fund to the shareholders in this case without first paying the creditors constitutes an evasion of this statutory obligation.

2. THE SHAREHOLDERS ARE NOT ENTITLED TO PRIORITY PAYMENT AS TORT CREDITORS OF ALLECO

Although the shareholders have also asserted tort claims against Alleco, this does not convert them from shareholders to creditors who are entitled to be paid ahead of the debenture holders in the liquidation of Alleco.

Section 510(b) of the Bankruptcy Code, 11 U.S.C. Section 510(b), provides for the subordination of fraud claims of shareholders to the claims of other creditors. The statute states:

> "(b) For the purpose of distribution under this title [11 USC Subsection 101 et seq.], a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 [11 USC Section 502] on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common

> stock, such claim has the same priority as common stock."

In Re Flight Transportation Corporation Securities Litigation, 730 F.2d 1128 (1984) makes the meaning of the section clear:

> According to this view, since 'the unsecured creditor [relies] of an apparent cushion of equity securities in making the decision to extend credit,' the risk of illegality in securities issuance should be borne by the securities purchasers, not the general creditors. House Report at 195, U.S.Code Cong. & Admin. News 1978, p. 6155. 'The general creditors have not had the potential benefit of the proceeds of the enterprise deriving from ownership of the securities and it is inequitable to permit shareholders that have had this potential benefit to shift the loss to general creditors.'

This provision is made applicable to the dissolution of Maryland corporations outside of bankruptcy by Maryland General Corporation Law Section 3-418(b) which provides:

> (1) Any preference, payment, or transfer made by the corporation which would be void, voidable or fraudulent under State law or the federal Bankruptcy Act if made by an insolvent or bankrupt is to the same extent void, voidable, or fraudulent, respectively, as to the corporation, and the receiver has the powers of a trustee in bankruptcy with respect to setting them aside.

The clear intent of this provision is to make the Bankruptcy Code applicable to a determination of the duties of the corporation and its owners to creditors.

Although the provision applies by its terms only to corporations in receivership, the same rules apply to insolvent corporations whether or not they are in receivership. Moreover, Alleco presently has a bankruptcy petition pending against it, filed on October 11, 1989. Under Maryland law, "In insolvency distributions, creditors have priority over shareholders," Chevy Chase

Savings & Loan v. State, 306 Md. 384, 402, 509 A.2d 670 (1986). There is no doubt that Alleco has liabilities -- including those to the debenture holders -- vastly in excess of its remaining assets, and therefore is "insolvent" under Section 2-301 of the Maryland General Corporation Law. It follows that because the Bankruptcy Code is applied under Maryland law to insolvent corporations that it would be unlawful to give defrauded shareholders priority over other creditors.

Equity Funding Corporation v. Sylvia Confino, et al., 603 F.2d 1353 (9th Circuit, 1979) shows that in a class action distribution, fraud claimants such as the Robinson stockholders and their attorneys are subordinated to holders of subordinated debt instruments. The fraud claimants are listed as Class 8 claimants whereas the holders of subordinated debt

instruments are listed as Class 7 instruments. Under the absolute priority rule of bankruptcy, the fraud claimants would be entitled to nothing. However, in order to avoid a dispute as to the value of previously distributed securities, Equity Funding debenture holders permitted a 12.3% recovery to security holders.

In Matter of Stirling Homex Corp., 579 F.2d 206, (2nd Circuit, 1978), defrauded common stockholders got nothing until general creditors were paid, whether subordinated or not.

Under the rules of distribution between unsecured creditors and stockholders who were defrauded whether in bankruptcy or in class action litigation, the defrauded stockholders and their attorneys get nothing until the unsecured creditors are paid in full.

3. APPROVAL OF THE SETTLEMENT WAS UNFAIR TO THE DEBENTURE HOLDERS BECAUSE DEBENTUREHOLDERS HAVE SUPERIOR INTERESTS AND BECAUSE THEY ARE TORT-CLAIMANTS ON AN AT LEAST EQUAL FOOTING WITH SHAREHOLDERS.

Even if the shareholders should be considered tort victims for purposes of determining their priority, this should not entitle them to payment ahead of debenture holders because the latter are victims of the same fraudulent conduct that injured the shareholders. They have sought redress for these wrongs in the District Court.

The petitioners have asserted substantial tort fraud claims against Alleco. These claims include, inter alia, allegations that the prospectus for the issuance of the convertible debentures contained numerous misstatements and omissions; that individual defendants engaged in numerous improper transactions that amounted to a

looting of Alleco; that individual defendants engaged in a price-fixing conspiracy that cost Alleco millions of dollars; that Alleco failed to report substantial liabilities to Waste Management Corporation; and that Alleco committed undisclosed federal income tax fraud.

Furthermore, as demonstrated above, payment of the Settlement Fund contravenes the Debentureholders' rights to participate in the liquidation of Alleco. The settlement -- including the provision for payment of the Fund -- should never have been approved. The courts have recognized that in approving a settlement, the rights of all corporate claimants, and not merely the class members who will benefit from the settlement, should be considered.

This principle is embodied not only in the cases concerning standing to

object to the settlement but also in the standards for approval of the settlement. Thus, in In re Warner Communications Securities Litigation, 798 F.2d 35 (2d Cir. 1986), the court approved the settlement of securities fraud and corporate claims. But Judge Newman, concurring, cautioned:

> settlement might well be shown to be unreasonable to a shareholder if the corporate defendant contributed so much more than a fair share as to cause a discernible incremental pro rata decline in the value of the stockholders stock below the reduction attributable to a fair contribution. That possibility is not present in this case because the Delaware Court of Chancery, in approving the settlement of the derivative action, determined that the allocation of burdens between the Corporation and the individuals was fair. In the absence of adjudication or judicially approved settlement of a parallel derivative action, however, assessment of the fairness of a shareholder's action would require some scrutiny of the fairness of the corporation's contribution.

In the present case, there has not only not been an adjudication of the allocation of burdens between shareholders and creditors, but there has not even been a hearing on the creditors' claims. The Corporation now proposes to pay everything to the shareholders. That is precisely the situation Judge Newman was worried about.

D. THE SETTLEMENT, WHICH PROVIDES FOR THE DESTRUCTION OF 25,000 NON-PUBLIC DOCUMENTS, IS INCONSISTENT WITH THE PUBLIC POLICY OF LIMITED PROTECTIVE ORDERS UNDERLYING FEDERAL RULE OF CIVIL PROCEDURE 26.

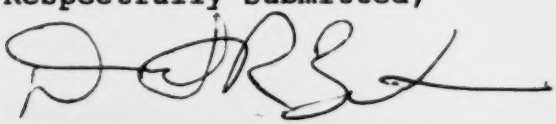
The settlement provides for the destruction of 25,000 non-public documents, is inconsistent with the public policy of limited protective orders underlying Federal Rule of Civil Procedure 26. Those 25,000 documents should be available to other tort-claimants with substantially the same

cause of action. Requiring every litigant with similar causes of action, debentureholders in this case, to "reinvent the wheel" raises the costs of litigation needlessly and will often make the cost of plaintiffs' vindicating their just rights prohibitive. This problem has recently received particular attention in the context of product liability litigation. See, 75 American Bar Association Journal 32 (November, 1989). Rule 26 recognizes the desirability of an open litigation process by requiring litigants to show good cause before they can secure a protective order sealing documents. Petitioners contend that the provision in the settlement that would provide for the secret destruction of 25,000 documents is invalid and should be disapproved.

CONCLUSION

For these reasons, the petition for a writ of certiorari should be granted.

Respectfully Submitted,



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FILING AND MAILING CERTIFICATE

I, Barbara E. Grove, hereby certify that on this 7th day of December, 1989, I filed with the Clerk's Office of the United States the foregoing Petition for a Writ of Certiorari and further certify that I mailed this same date the required copies to the opposing counsel listed below:

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